

When Financial Businesses Fail: Protection for Account Holders

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Summary

After the onset of the current financial crisis and economic contraction, the 111th Congress increased some of the long-standing provisions that protect account holders from risk. Specifically, provisions in the Emergency Economic Stabilization Act of 2008 (EESA; P.L. 110-343) and the Helping Families Save Their Homes Act of 2009 (HFSTHA; P.L. 111-22) increased account holders' protection. Both laws raised the maximum deposit account insurance to \$250,000, and the HFSTHA extended the higher level of risk protection until 2013.

Lawmakers have long recognized the importance of protecting some forms of financial savings from risk. Such provisions apply to deposits in banks and thrift institutions and credit union "shares." Remedial and other safety net features also cover insurance contracts, certain securities accounts, and even defined-benefit pensions. Questions over how to fund and guarantee Social Security, along with the troubles of the Pension Benefit Guaranty Corporation, have renewed interest in these arrangements.

This report portrays the salient features and legislation of account protection provided by the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Share Insurance Fund (NCUSIF), state insurance guaranty funds, the Securities Investor Protection Corporation, and the Pension Benefit Guaranty Corporation. It provides a discussion of the FDIC's Temporary Liquidity Guarantee Program (TLG), which extends unlimited temporary deposit guarantees to certain depositors and debt held in insured depository institutions. Overall, the report provides a summary of the major federal risk protections for account holders.

This report will be updated as appropriate.

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Federal Protection for Account Holders

Federal lawmakers view many financial businesses as having an important role in the U.S. economy, and therefore warrant providing these businesses protection for their individual account holders against loss, should the firms fail. Such protections exist both to protect the individuals from risks they probably could not discern for themselves and to protect the economy against the effects of financial panics when failures occur. Panics, the attendant collapses of wealth, and severe consequences for the economy occurred before Congress created federal deposit insurance in 1934.

Prior to the enactment of the Emergency Economic Stabilization Act of 2008 (EESA; P.L. 110-343), government policy protected customers of depository institutions—banks, thrift institutions, and credit unions—in full for accounts up to \$100,000 and up to \$250,000 for retirement accounts. Although the enactment of EESA on September 23, 2008, immediately raised the maximum deposit insurance to \$250,000, retirement accounts remain at \$250,000 until December 31, 2009. Since then, Congress and the President enacted the Helping Families Save Their Homes Act of 2009 (HFSTHA; P.L. 111-22), extending both the EESA increases and the Federal Deposit Insurance Corporation's (FDIC's) \$30 billion borrowing authority from the U.S. Treasury to as much as \$500 billion until 2013. Because of the wording of P.L. 111-22, after 2013, it is possible that deposit insurance protection could revert back to the \$100,000 and \$250,000 for retirement accounts.¹ Other institutions such as insurance companies, securities broker/dealers, and many pension funds receive government or government-sponsored guarantees on specified accounts.

Major Features of Customer Protection Systems

This report provides a summary of the major features of financial institutions' customer protection systems, reflecting safety-net provisions legislated over time, usually in reaction to specific financial collapses. Besides these explicit guarantees, regulatory bodies can attempt the rescue of failing financial enterprises, using many tools authorized by laws and regulations and often implemented in the background. Such tools include liquidity lending, arranging memoranda of understanding, issuing cease-and-desist orders against risky practices, and arranging mergers of weak entities into stronger institutions.

If the entire financial economy seems threatened by pending collapse of either a sizeable financial institution that is "too big to fail" or many financial businesses collectively, the Federal Reserve (Fed) can step in as the lender of last resort to avert serious adverse consequences for the economy (e.g., use of the Fed's liberal bank liquidity policy immediately after the 9/11 attacks, and currently the subprime meltdown led to failures of institutions once believed to be too big to fail—Bear Stearns, Fannie Mae, Freddie Mac, and AIG—all of which were or are being assisted by the federal government). Moreover, Congress may have to provide emergency funding when parts of the federal safety net are under severe pressure. The cleanup of the savings and loan industry in the 1980s and early 1990s, for example, required appropriated funds plus a new deposit insurance fund and regulator. A more recent example is the Emergency Economic Stabilization Act of 2008, which provided \$700 billion to purchase distressed assets, and has been used to make direct capital investments in troubled financial institutions.²

¹ CRS Report R40413, *The Federal Deposit Insurance Corporation (FDIC): Efforts to Support Financial and Housing Markets*, by Darryl E. Getter and Oscar R. Gonzales, and CRS Report RS20724, *Federal Deposit and Share Insurance: Proposals for Change*, by Walter W. Eubanks.

² See CRS Report RL34730, *Troubled Asset Relief Program: Legislation and Treasury Implementation*, by Baird Webel and Edward V. Murphy.

An important conceptual distinction between support structures is who ultimately pays for the protection. Lawmakers originally created federal deposit insurance using a “user fee” model of insurance, in which the government owned and operated each insurance system and charged member banks for its use. Following the banking failures of the late 1980s — early 1990s, legislation moved deposit protection part way toward an alternative “mutual” model, in which the burden of financing the system falls more clearly on the banking industry. Mutual institutions are owned by their customers, such as saving associations’ depositors and insurance companies’ policyholders. As a result, some analysts now claim that the banking industry “owns” the deposit insurance fund (DIF) in mutual mode. However, when the FDIC begins to draw on its credit line at the U.S. Treasury, which it has never done before, the use of the credit line would move the system back to the user fee model as the banks would have to pay their FDIC assessments as well as pay back the borrowed funds to the federal government, which owns and operates the DIF.

The ultimate guarantor of deposit insurance is the economic power of the federal government, particularly the power to tax. History has shown that deposit guarantees by governments beneath the federal level have universally been inadequate to prevent panics, runs, and severe economic damage when called upon. Industry-sponsored and state-level programs have contained the collapses of their covered entities only if the damages have been small. The troubled pension benefit arrangement remains mainly in user fee mode. Credit union share insurance, in contrast, more nearly follows the mutual model. Likewise, state insurance company guaranty and federally sponsored securities investor protection arrangements follow the mutual model. However, in the current financial crisis, the National Credit Union Administration (NCUA) has joined the FDIC in accepting an increased line of credit from the U.S. Treasury to resolve failing corporate credit unions and restoring the National Credit Union Share Insurance Fund (NCUSIF). Corporate credit unions are owned by retail or natural credit unions. Corporate credit unions operate as wholesale credit unions providing financing, investments, and clearing services for natural credit unions. It was the corporate credit unions that suffered most of the industry’s losses in the current subprime foreclosure turmoil. Consequently, like the FDIC, when the NCUA uses its U.S. Treasury credit line to stabilize the NCUSIF, it too would move closer to the user fee mode.

The following tabulation lists the major elements and components of these safety nets. **Table 1** compares account protection at depository institutions. **Table 2** does the same for the non-depository supports. Readers may obtain further analysis of each system via the websites of the administering agencies noted.

Table 1. Comparison of Account Protection: Depository Institutions

Feature	Bank Deposits	Thrift Institution Deposits	Credit Union Shares
Statutory Authority	Federal Deposit Insurance Act	Same	Federal Credit Union Act (Amendment)
Original Date/ Major Modification	1933/1991/2005/2008/2009	1934/1989/1991/2005/2008/2009	1970/2005/2008/2009
Citations to Authority and Operations	64 Stat. 873; 12 U.S.C. 1811 ff. P.L. 110-343, Sec.346A	Same as bank deposits	84 Stat. 994; 12 U.S.C. 1781 ff; P.L. 110-343, Sec. 346A
Administrator	Independent agency: Federal Deposit Insurance Corporation's Deposit Insurance Fund.	Same as bank deposits	Independent agency: National Credit Union Administration manages National Credit Union Share Insurance Fund.
Funding	Banks pay assessments on deposits to maintain fund balance: currently zero for all but riskiest firms.	Same as bank deposits	All federal and electing states may pay assessments; none recently. Contribution of 1% of credit union "shares" required.
Federal Budgetary Status	Part of consolidated federal budget.	Same as bank deposits	Members own off-budget fund.
Federal Government Backstop	Up to \$500 billion line of credit with U.S. Treasury; "full faith and credit of the United States."	Same as bank deposits	\$6 billion line of credit with U.S. Treasury; "full faith and credit of the United States."
Risk-Based Assessment	Yes: institutions holding more risky assets pay more per \$100 of covered deposits.	Same as bank deposits	No
Tax Deduction for Assessment	Yes: Business expense deduction for taxes.	Same as bank deposits	None usually since credit unions are exempt from federal and most state taxes.
Product Line Differentiation	None	None	None
Coverage Limit	\$250,000 per account and no limit for certain account.	Same	\$250,000 for standard share account.

Source: Congressional Research Service. This information was drawn from laws, regulations, and practices the institutions.

Table 2. Comparison of Account Protection: Non-depository Institutions

Feature	Insurance Policies	Securities Accounts	Pension Accounts
Statutory Authority	State laws. McCarran-Ferguson Act (59 Stat. 33, 1945) removed most federal industry involvement.	Securities Investor Protection Act of 1970	Employee Retirement Income Security Act of 1974; ^a Consolidated Appropriations Act, 2001; Deficit Reduction Act of 2005; Pension Protection Act of 2006.
Original Date/ Major Modification	Various.	1970	1974/1994/2000/2005
Citations to Authority and Operations	State laws.	84 Stat. 1636; 15 U.S.C. 78aaa ff.	88 Stat. 829; 29 U.S.C. 1001 ff.
Administrator	Multi state administrators and non-profit associations of licensed insurers; coordinated via National Association of Insurance Commissioners and National Conference of Insurance Legislators.	Non-governmental membership corporation, funded by member securities broker-dealers: Securities Investor Protection Corporation.	"Self-supporting" federal government corporation: Pension Benefit Guaranty Corporation.
Funding	Licensed direct insurers pay after actual insolvency; no funds(s) generally exist.	Assessments on members for "reserve" fund advancing payments to claimants: flat \$150 yearly per firm. Corporation may levy revenue-based assessment, as in 1989-1995.	Employers pay annual premium per participant: \$30 minimum in single-employer/\$8.00 flat in multi-employer plans.
Federal Budgetary Status	Not applicable.	Not a budgetary account.	Trust Fund is off-budget, while the revolving fund is on-budget.
Federal Government Backstop	None, except for a program of terrorism reinsurance.	May borrow \$1 billion from U.S. Treasury Department through Securities and Exchange Commission; lacks "full faith and credit" backup.	Borrowing or appropriation has not covered fund deficits; lacks "full faith and credit" backup.
Risk-based Assessment	No.	No.	Yes: Underfunded single-employer plans pay extra \$9/1,000 on unfunded vested benefits, varying with interest rates
Tax Deduction of Assessment	Yes: Life insurers in 45 states and property-liability insurers in 20 may deduct assessments from premium taxes; business expense deduction for federal and state taxes.	Essentially not applicable, although business expense tax deduction is nominally available.	Yes: Employers' business expense deduction for federal and state taxes.

Feature	Insurance Policies	Securities Accounts	Pension Accounts
Product Line Differentiation	Insurers are assessed by market share in particular types of insurance.	None.	Program for single-employer plans; another for multi-employer plans.
Coverage Limit	Coverage limits vary by state	Stocks, bonds, and cash registered to holders in closed broker/dealers; \$500,000 of which \$100,000 may be cash; not protected against changing market values.	Varies. Single-employer plan basic benefits to \$54,000 annually for retirees starting at age 65, adjusted for age and inflation. Multi-employer plan formula is 100% of first \$11 of monthly benefits per year of service plus 75% of the next \$33 of such benefits, not adjusted.

Source: Congressional Research Service. This information was drawn from laws, regulations and practices of the institutions,

- a. See CRS Report RL34443, *Summary of the Employee Retirement Income Security Act (ERISA)*, by Patrick Purcell and Jennifer Staman.

Additional Protection: FDIC Temporary Liquidity Guarantee (TLG) Program

On October 23, 2008, in the midst of the current financial crisis, the FDIC announced its Temporary Liquidity Guarantee program to help unfreeze the U.S. short-term credit markets. At the time, financial institutions were not lending to each other, especially in the commercial paper market, which was almost completely frozen. The two-part program temporarily guarantees all new senior unsecured debt and fully guarantees funds in certain non-interest bearing accounts at FDIC-insured institutions issued between October 14, 2008, and June 30, 2009, with guarantees expiring no later than June 30, 2012. The FDIC expects these guarantees would restore the necessary confidence for investors to begin investing in obligations of depository institutions. Evidence suggests that these short-term markets returned to normal after the TLG program was implemented.

The second part of the FDIC's TLG program is to guarantee 100% of non-interest-bearing transaction accounts held in insured depository institutions until December 31, 2009. This addresses the concern that many small business accounts, such as payroll accounts, frequently exceed the current maximum deposit insurance limit of \$250,000. The TLG program is being paid for by additional fees placed on depository institutions that use these guarantees, not taxpayers.³

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³ Thecla Fabian, "FDIC Board Approves Formal Notice of Temporary Liquidity Guarantee Program," *BNA Banking Report*, October 27, 2008, p. 714, and FDIC website at <http://www.fdic.gov/news/news/press/2008/pr081105.html>.